

FINAL STATEMENT OF REASONS  
FOR RULE CHANGES UNDER THE  
CORPORATE SECURITIES LAW OF 1968

As required by Section 11346.2 of the Government Code, the California Corporations Commissioner ("Commissioner") sets forth below the reasons for the adoption of amendments to Section 260.102.14 of the California Code of Regulations (10 C.C.R. Sec. 260.102.14).

The Corporate Securities Law of 1968 (the "CSL," Corporations Code Section 25000, et seq.) requires the offer or sale of securities in this state to be either qualified, exempt from qualification, or not subject to qualification. Section 25102(f) of the Corporations Code sets forth an exemption from the qualification requirement for transactions where (1) the sale is to 35 or fewer persons, (2) each purchaser has a preexisting relationship with the securities issuer or business or financial experience to protect his or her own interests, (3) each purchaser represents the purchase is for that person's own account, (4) the offer or sale is not accomplished through advertising, and (5) the issuer files a notice with the Department of Corporations ("Department") within 15 days of the first transaction. Section 25102(f)(4) further provides that the Commissioner may by rule require the issuer to file a notice of transactions. Rule 260.102.14 sets forth the form for the filing of the notice, and the accompanying instructions. Rule 260.102.14 currently allows (but does not require) an issuer to file a note of transfer.

The adoption of amendments to Rule 260.102.14 require the online filing of the notice in lieu of the paper form.

The mandated electronic filing process is needed to improve government efficiency and service to the public, and to reduce operating costs. Senate Bill 220 (Chapter 273, Statutes of 2003) allows the California Corporations Commissioner to prescribe circumstances under which to accept electronic records, as specified. Among other things, SB 220 added Corporations Code Section 25620 to provide, in part: "The Legislature hereby finds and declares that the Department of Corporations has continuously implemented methods to file records electronically, including broker-dealer and investment adviser applications, and is encouraged to continue to expand its use of electronic filing to the extent feasible, as budget, resources, and equipment are made available to accomplish this goal."

The amendments to subsection (e) of Rule 260.102.14 are to carry out the goal of expanding electronic filings, as encouraged by the Legislature. To avoid any unreasonable burden or expense to an issuer that cannot file electronically, this rulemaking also adds subsection (f) to Rule 260.102.14. As amended, subsection (f) would allow an issuer to file the paper notice in person or by mail only if: (1) computer equipment including hardware and software is unavailable to the issuer without unreasonable burden or expense, or it is impossible for the issuer to obtain and provide the information requested on the notice through electronic filing. This exception is

needed to accommodate an issuer based on these types of hardships. In addition, the new provisions require the issuer to check the applicable box and describe the reason(s) and description(s) for the hardship exception, as specified. The hardship exception proposed in subsection (f) is similar to the exception provided by the Securities and Exchange Commission under Regulation S-T (69 Fed. Reg. 22704 (April 26, 2004)) and provides flexibility for the issuer in cases where unreasonable burden or expense makes it impossible or impracticable to file the notice through electronic means. While the Department understands the term "unreasonable" burden or expense may lack clarity, the Department prefers to leave this term undefined for two reasons. First, leaving this term undefined will enable the issuer to have sufficient flexibility to determine the extent of the burden or expense involved in filing the notice electronically. Second, the Department desires to review the exceptions filed in the future, to determine how the term "unreasonable" can be clarified based on a sample of ongoing filings. The Department does not anticipate many hardship exception filings since issuers are likely to either own, or have access to, computer equipment with Internet capability, and are likely to obtain and provide the requested information.

This rulemaking also amends subsections (a) and (c) of Rule 260.102.14 to conform to the changes made in subsection (e) and to clarify the filing obligations of issuers pursuant to the modified rule.

This rulemaking made additional technical changes which were made available for fifteen (15) days. These changes: (1) incorporated the hardship exception information in item 8 of the notice rather than requiring a separate letter; (2) moved certain information from item 8 to item 9 (e. g., date, signatory, consent to service, contact person); and (3) provided a bold type face heading pertaining to the electronic filing and hardship exception, at the top of the notice. These minor revisions are needed to facilitate compliance with the electronic filing requirement by making the notice and instructions easier to read, easier to understand, and easier to complete. These changes are "sufficiently related" as that term is used in Government Code Section 11346.8 because they merely clarify and confirm information that was already available to the public through the original public comment period.

#### DETERMINATIONS

The Commissioner has determined that the proposed regulatory action does not impose a mandate on local agencies or school districts, which require reimbursement pursuant to Part 7 (commencing with Section 17500) of Division 4 of the Government Code.

#### ALTERNATIVES CONSIDERED

No alternative considered by the Department would be more effective in carrying out the purpose for which the regulation is proposed or would be as effective and less burdensome to affected private persons or would lessen any adverse impact on small businesses.

## ADDENDUM, REGARDING PUBLIC COMMENTS

In addition to the Department's regular mailing and publication for purposes of distributing proposed regulations, the Department notified the State Bar's Business Law Section and Corporations Committee comprised of lawyers practicing before the Department, for the purpose of ensuring wide distribution of the proposed regulations. It is noteworthy that no request for hearing was received during the 45-day public comment period, which ended on October 11, 2004. As a result, no hearing was scheduled or held. Moreover, the Department received comments from only three individuals. These comments and the Department's responses are summarized below.

### COMMENTS RECEIVED DURING THE 45-DAY COMMENT PERIOD

COMMENTOR: Diana Woods, Senior Corporate Paralegal & Coordinator, by e-mail dated October 5, 2004.

COMMENTS: The commentor expresses concerns with using a credit card and states that the Department should consider a payment system similar to the one implemented by the California Secretary of State.

RESPONSE: Although the commentor does not specify any problems with the credit card payment process, the Department of Corporations notes that it is receiving a very high customer satisfaction rate in terms of ease of use, taking less than 20 minutes to file the notice, the importance of maintaining the system over the internet, and customer satisfaction with the electronic filing system. An example of recent survey comments includes, "It was the easiest Blue Sky filing I ever done!" As another example, "The process is excellent. Much better than the Secretary of State of California or the IRS. Keep up the good work." Nevertheless, the Department is exploring other payment options including ACH electronic transfer, as an alternative to a credit card. In addition, the California Secretary of State's electronic filing system is different from the Department of Corporations' system. The Secretary of State's system is tailored to UCC filings pursuant to an electronic system prescribed by statute. Because businesses typically file numerous UCC notices on a daily basis, a prepayment system may be necessary and appropriate to accommodate these filers. Nevertheless, the Department of Corporations will continue to explore other payment options, if they become necessary or appropriate.

COMMENTOR: Mark Lubin, of Stein & Lubin LLP, by e-mail dated October 7, 2004.

COMMENTS: The commentor states that payment by credit card will place an accounting burden on law firms and their employees and therefore recommends that the issuer mail a check within 10-days after the electronic filing is submitted.

RESPONSE: In addition to the response to the first commentor, above, the Department notes that its electronic filing system (including the credit card payment process) was developed in consultation with attorneys and law firms which practice before the Department of Corporations. Experience has shown that law firms may obtain

a credit card to pay the filing fee for the electronic notice and bill their clients for that amount. As part of the electronic process, the law firm can obtain a written document to demonstrate each notice filing, reconcile payments made for clients, and thereby eliminate any accounting burdens. Allowing payment by check would be contrary to the rule's purpose. The electronic filing system makes the notice filing and payment process more efficient (at the click of a button), with no paper work or check to submit or lose. If a check is lost or includes an inaccurate amount, there may be a delay in the processing of the notice. Any delay may cause the issuer to incur additional expense and burden. For these reasons, the electronic payment system is more efficient and exposes the issuer and its counsel to less risk and burden. Nevertheless, the rule does provide a hardship exemption for persons that cannot provide the requisite information without unreasonable burden or expense, as specified.

COMMENTOR: Richard G. Burt, Attorney and Counselor, by e-mail, facsimile and letter dated October 7, 2004.

COMMENT 1: Under the heading of "Burden," commentor states: most issuers will not have a credit card; the electronic filing results in accounting work for law firms; American Express is not yet allowed under the electronic payment system; and the computer information may be comprised.

RESPONSE: In addition to the response to the previous commentor, to address the concerns regarding the inability to pay by credit card, the Department's rule provides a hardship exemption where providing the information would impose unreasonable burden or expense, as specified. The Department is considering other payment options such as American Express. As part of the electronic filing process, the filer receives a written accounting report to identify the filings, reconcile payments and thereby avoid any accounting burdens. Moreover, it is noteworthy that the Department provides a toll-free number, assistance from staff, including one-on-one guidance, to assist filers before, during and after the online filing process. Finally, as with any state computer storing sensitive information, the Department's computer system must meet all applicable security requirements. These requirements include, but are not limited to, state security policies outlined in the State Administrative Manual Sections 4840 through 4845 and any other state mandates including the Government Code.

COMMENT 2: Under the heading "Authority," the commentor contends that the Department lacks authority to require electronic filing of a notice under Corporations Code Section 25102(f).

RESPONSE: The Department has broad authority to require electronic notice filings under Corporations Code Section 25620, including rules to require electronic notice filings and fees for purposes of Corporations Code Section 25102(f)(4). Corporations Code Section 25102(f)(4), the Commissioner may by rule require the issuer to file a notice of transaction under the subdivision. Moreover, the authority provided by Corporations Code Section 25165 and 25610 enable the Department to draft and implement rules, forms and orders as necessary to carry out the provisions of the Corporate Securities Law

of 1968, including rules and forms governing applications and reports, and defining any terms such as the definition of fee. Consistent with its authority, this rulemaking defines and makes specific the manner of filing a notice and fee with the Department.

COMMENT 3: Under the heading of "Federal Law," the commentor suggest that federal law may require the Department to accept United States currency.

RESPONSE: The Department is unaware of any federal requirements. However, it is noteworthy that the United States Securities and Exchange Commission is working on a project similar to the Department's to require electronic filing of Regulation D notices similar to California's proposal to require electronic filing 25102(f) notices.

In an October 8, 2004 letter, Mr. Burt also states that it is unclear whether a lawyer can sign the notice on behalf of an issuer and, if the client files the notice online, he or she may make a mistake.

RESPONSE: As with the paper version of the notice, the electronic notice form allows an authorized representative such as a lawyer to sign the notice on the issuer behalf. If the issuer completes the electronic filing (with or without supervision of counsel), the electronic form is easier to read, easier to understand, and easier to complete. This electronic version is design to be completed by any issuer or its representative, even without the assistance of counsel. This system helps eliminate any risk of error, for the reasons stated above.

#### COMMENTS RECEIVED DURING THE 15-DAY COMMENT PERIOD

No written comments were received during the 15-day comment period, which ended on January 10, 2005.

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